OFFICE OF THE MISSOURI STATE TREASURER
SARAH STEELMAN, TREASURER

Date: August 28, 2005

To: Board Members of the Missouri Higher Education Savings Program

From: Mark Mathers
Director of Investments, Missouri State Treasurer's Office

RE: 2005 ANNUAL PROGRAM REVIEW

Section 166.450, RSMo requires an annual review of the Missouri Higher Education Savings Program (or "MO$T") by the director of investments of the state treasurer's office and the reporting of findings to the MO$T Board. The statute requires a review of five areas:

- Board administration
- Investment policy
- Financial status
- Participation rate
- Continued viability

Therefore, in accordance with these requirements, I am pleased to present the following findings from my review for calendar year 2005. When possible, I have attempted to use comparative data on other states' plans available from the College Savings Plan Network (CSPN) to supplement my analysis of TIAA-CREF's quarterly reports. I am available to discuss these findings at your convenience.

Board Administration

In 2005, the MO$T program administrator was the Teachers Insurance and Annuity Association – College Retirement Equities Fund (TIAA-CREF). The program administrator managed the day-to-day operations of the MO$T program and made policy recommendations to the Missouri Higher Education Savings Program Board (the "Board"). The Board and the State Treasurer's Office worked closely with the administrator and monitored the administrator's management of the program. The Board met quarterly during 2005, as required by law.

Investment Policy

The Missouri Higher Education Savings Program does not retain a separate investment policy governing MO$T investments. The establishment of investment options and asset allocation changes are set by the Board based on recommendations of TIAA-CREF. The asset allocations approved by the Board thus serve as the *de facto* investment policy for the program. Therefore, I have included my review of the MO$T program's asset allocation under this section.

Asset Allocation Changes

In 2005, TIAA-CREF continued to offer three investment options to participants: an age-based managed allocation, a 100% equity option and a guaranteed option. Each year, the program administrator performs an extensive asset allocation study, which the Board utilizes to adopt an asset allocation policy for the MO$T program. Any change in asset allocations is expected to reduce participant risk and/or maximize participant returns.

In part based on concerns expressed by Treasurer staff regarding the performance of several funds, TIAA-CREF revised the lineup for its Managed Allocation Option in 2005 to exclude actively managed funds and thus dropped the Growth & Income Fund and Growth Equity Fund. In these two funds' place, TIAA-CREF's Large Cap Growth Index Fund and S&P 500 Index Fund were inserted. In explaining this change, TIAA-CREF staff expressed the belief that participants in the Managed Allocation Plan are not necessarily trying to "beat the market" (i.e., achieve alpha); rather, they should be able to achieve their aims through a more conservative index approach over the long term.

So, for 2005, for the first time, the Managed Allocation Fund contained only passive index funds with the exception of the International Equity Fund.[1] Additionally, TIAA-CREF recommended a slight shift in the fixed income allocation towards their Bond Fund and away from the Inflation Linked Bond Fund based on their asset allocation models. Overall, the asset allocation to equities versus fixed income remained the same as 2004.

For the 100% Equity option, TIAA-CREF recommended the following:

[1] TIAA-CREF does not manage a passive International Equity index fund.

- Dropping the Growth & Income Fund due to poor performance
- Dropping the passive index-based Small Cap Blend Index and Large Cap Value Index funds and essentially replacing them with the actively managed Small Cap Equity (Active) and Large Cap Value (Active). TIAA-CREF also recommended reducing the allocation of the passive Equity Index Fund from 35.0% to 8.4%.
- Increasing the allocation of the Growth Equity Fund from 0.0% to 27.7% of the allocation.
- The new Large Cap Value (Active) Fund also was recommended to receive a large allocation (28.4%).

Essentially, TIAA-CREF recommended a shift from index-based funds to actively managed funds. For the most part, these new actively managed funds are enhanced index funds, which seek to maintain a risk profile for each fund similar to its benchmark index yet generate alpha through superior stock selection and/or quantitative analysis. TIAA-CREF's shift here is based on their perception that the 100% Equity Option is intended to supplement the Managed Allocation option – that is, participants can open a second account with this option if they prefer a more aggressive investment style and/or they want greater exposure to equities. TIAA-CREF felt that the more aggressive style of actively managed funds was what appealed to users of this option.

Findings:

1. The diversification of mutual funds for the Managed Allocation and 100% equity options is appropriate.

2. TIAA-CREF's recommendation to shift to a pure index fund approach for the age based investment option and a pure actively managed fund approach for the 100% Equity Option makes some sense. However, we questioned TIAA-CREF's assumption that all investors in the 100% Equity Option have a more aggressive appetite and are trying to "beat the market". We believe there are many investors in the 100% Equity Option who simply believe that 100% exposure to an equities fund is necessary to generate the returns required to exceed tuition inflation. Investors in the 100% Equity Option would need to see better performance from TIAA-CREF's active funds in the future to even match the returns of fund benchmarks.

3. With the addition of the Advisor series in 2003 and the new Certificate of Deposit program authorized in 2005, the Board may wish to consider adopting a separate, stand-alone investment policy for the MO$T program in the future. The advantage of a separate investment policy is that it would allow the Board to publicly articulate its policies, performance standards and benchmarks in order to set consistent guidelines for all of these programs. An investment policy potentially also could include areas such as definition of the roles and responsibilities of staff and program administrators, operating performance standards and due diligence requirements.

Financial Status

As was the case for last year's report, in this section, we review the financial status of TIAA-CREF and the performance of underlying funds for its program lineup.

Financial Status of TIAA-CREF

A review of TIAA-CREF's creditworthiness is appropriate for two primary reasons. First, as the MO$T program administrator, any credit issues involving TIAA-CREF exposes MO$T to both operational and reputational risk. Secondly, a review of the credit quality of TIAA is necessary because MO$T's Guaranteed Option relies on an unsecured funding agreement with TIAA-CREF Life, a subsidiary of TIAA.

CREF is a membership corporation registered with the SEC as an investment company. Its companion organization, TIAA, is a non-profit stock life insurance company. TIAA-CREF represents one of the world's largest private pension systems, based on total assets under management of $371 billion at December 31, 2005.

Audited financial statements for TIAA-CREF were not available for review at the time this report was prepared. However, TIAA-CREF's annual report notes that total assets under management increased 7% in 2005 and that income before taxes and net realized capital gains and losses increased 60%. Additionally, all three major rating agencies have assigned a long-term rating of "AAA", the highest possible rating, to TIAA-CREF. During 2005, Moody's Investors Service, Fitch Ratings and Standard and Poor's all affirmed a stable outlook for the firm.

Findings: TIAA-CREF retains a strong balance sheet. In late 2002, Herb Allison, formerly president of Merrill Lynch, was appointed CEO of TIAA-CREF. The company's "AAA" rating and its avoidance in any of the mutual fund scandals that have rocked the industry help to mitigate any operational or reputational risks to MO$T.

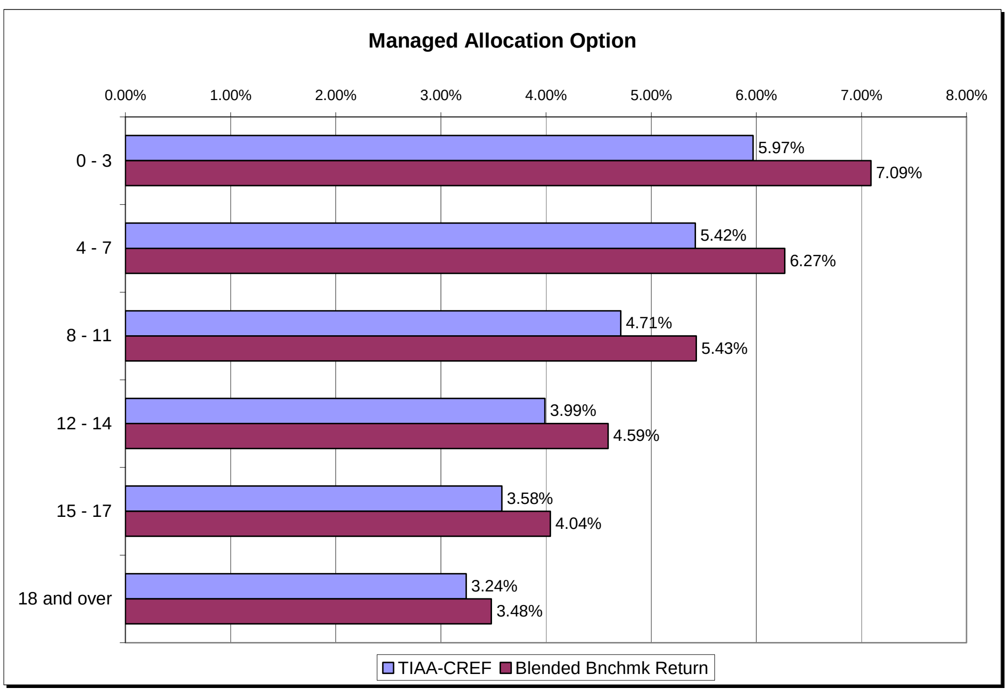
Fund Performance

For participants of the MO$T program who select either the Managed Allocation Option or the 100% Equity Option in the Direct Program, TIAA-CREF allocates contributions, along with any return on those contributions, among a combination of TIAA-CREF mutual funds. The allocation guidelines for the Managed Allocation Option are set using certain age bands, which are based on the beneficiary's year of birth. As beneficiaries age, they move from one age band to the next. The allocations among TIAA-CREF mutual funds are different for each age band – the younger the beneficiary, the more contributions are weighted towards equities and real estate. As beneficiaries age, an increasing percentage of funds are allocated to bond and money-market investments. The allocations of the 100% Equity Option do not change based on the age of beneficiaries, but the allocations may be modified periodically by the Board based on market conditions or other considerations.

The monitoring of these mutual funds is a critical component in protecting participants' interests and achieving the MO$T program's long-term investment goals. Such a review may include both quantitative and qualitative factors (e.g., compliance with investment guidelines, stability of fund personnel, review of the fund's strategy and style, etc.). Quarterly, TIAA-CREF presents the total returns of its funds and compares these to recommended benchmarks.

As indicated in the "Asset Allocation Changes" section, TIAA-CREF recommended and the Board subsequently adopted a fundamental change in the two equity-oriented investment options in the Direct Plan. Beginning with the implementation of these changes in April 2005, the Managed Allocation option primarily included passive index funds, where the only real tracking error compared to the corresponding benchmark index is attributable to the overall program cost for MO$T of 0.65%. In contrast, the 100% Equity Option now includes primarily actively managed funds, which can and do vary from their benchmarks' returns based on the portfolio management team's skills, risk controls, and other factors. These actively managed funds entail a greater responsibility to review their performance periodically.

The following table summarizes the performance of the Managed Allocation bands for 2005. Because of the implementation of the asset allocation changes in April 2005 (a third of the way in the calendar year), some bands absorbed a greater loss than the program cost of 0.65%. This was due to the underperformance of certain actively managed funds from January 2005 through the asset allocation implementation in April.



The above returns include all relevant expenses, most notably TIAA-CREF's program management fee of 65 basis points (bp). Overall, participants in the Managed Allocation option saw net returns that were between 24 and 112 basis points below that of their representative blended benchmark during 2005. As shown in the preceding chart, participants in the 0-3 and 4-7 age groups suffered from the weakest performance due to their greater exposure to equity funds.

Performance in the 100% Equity Option also trailed its blended benchmark in 2005 but was better on a relative basis than in 2004. TIAA-CREF's return of 7.78% compared to benchmark returns of 8.49% (for a difference of 0.71%). However, if the recommended asset allocation for the 100% Equity Option had been implemented on January 1, 2005 versus April 2005, the aggregative return for the 100% Equity Option would have been 1.02% lower than the blended benchmark.

<u>100% Equity Option Returns</u>

Fund	Type	Allocation	TIAA-CREF Return	Bchmk Return	Over/ (Under)
Growth Equity Fund	Active	27.7%	5.33%	5.26%	0.07%
Equity Index	Passive	8.4%	6.05%	6.12%	-0.07%
Large Cap Value	Active	28.4%	5.16%	7.05%	-1.89%
Small Cap Equity	Active	5.6%	3.44%	4.55%	-1.11%
International Equity	Active	20.0%	14.78%	13.54%	1.24%
Real Estate	Active	10.0%	7.19%	14.06%	-6.87%
Agg. Return based on Above Allocation			**7.32%**	**8.34%**	**-1.02%**
Actual Returns*			**7.78%**	**8.49%**	**-0.71%**

* Actual returns are based on the blended rate for the 2004 asset allocation that remained in effect until approx. April 2005 and the 2005 asset allocation in effect after that point.

Last year, TIAA-CREF's Growth & Income Fund, International Equity Fund and Real Estate Securities Fund underperformed their benchmarks. In 2005, the International Equity Fund rebounded but the Real Estate Fund continued to perform badly, trailing the Wilshire Real Estate Index by almost 7%. The relatively new Small Cap Equity and Large Cap Value funds also underperformed their respective indexes.

The spotty performance of TIAA-CREF's actively managed funds continued a pattern we have seen over the last three calendar years where different funds have underperformed but with at least one fund's weaker performance outside of tolerable ranges. The following page shows the quarterly performance of the underlying funds for the 100% Equity Fund in 2005.

TIAA-CREF Mutual Fund Total Returns

Fund	TK	2005-Q1	2005-Q2	2005-Q3	2005-Q4	2005 CY
100% Equity Fund						
Growth Equity						
TIAA-CREF Returns	TIEQX	-4.99	2.78	5.11	2.62	5.33
RUSSELL 1000 GROWTH INDX	RLG	-4.09	2.46	4.01	2.98	5.26
Variance		**-0.90**	0.32	1.09	**-0.36**	0.07
Equity Index						
TIAA-CREF Returns	TIEIX	-2.18	2.24	3.96	2.00	6.05
RUSSELL 3000 INDEX	RAY	-2.20	2.24	4.02	2.06	6.12
Variance		0.02	0.00	**-0.05**	**-0.06**	**-0.07**
Lg Cap Value Fund						
TIAA-CREF Returns	TRLIX	-1.84	1.59	2.49	2.90	5.16
RUSSELL 1000 VALUE INDEX	RLV	0.09	1.68	3.89	1.31	7.11
Variance		**-1.93**	**-0.09**	**-1.40**	1.59	**-1.95**
Sm Cap Equity						
TIAA-CREF Returns	TISEX	-5.54	3.82	4.14	1.29	3.44
RUSSELL 2000 INDEX	RTY	-5.34	4.36	4.71	1.15	4.63
Variance		**-0.20**	**-0.54**	**-0.57**	0.14	**-1.19**
International Equity						
TIAA-CREF Returns	TIIEX	0.55	-2.62	13.10	3.65	14.78
MSCI EAFE	MXEA	-0.17	-1.01	10.38	4.08	13.54
Variance		0.72	**-1.61**	2.72	**-0.43**	1.24
Real Estate Securities Fund						
TIAA-CREF Returns	TIREX	-6.81	13.76	-1.11	2.24	7.19
Wilshire Real Estate Securitie	WARESI	-6.43	14.13	3.75	2.95	14.06
Variance		**-0.38**	**-0.37**	**-4.86**	**-0.71**	**-6.87**

For the Advisor Program, a total of six underlying TIAA-CREF mutual funds were offered to advisors and their clients. Of the five equity funds offered, the two actively managed funds—the International Equity Fund and Growth & Income Fund—outperfromed their respective benchmarks by more than 100 bp in 2005. The quarterly and annual returns of these funds are shown in the following table.

TIAA-CREF Mutual Fund Total Returns

Fund	TK	2005-Q1	2005-Q2	2005-Q3	2005-Q4	2005 CY
Advisor Plan						
Growth & Income						
TIAA-CREF Returns	TIGRX	-1.69	1.30	4.39	2.29	6.35
S&P 500 INDEX	SPX	-4.09	2.46	3.60	2.09	4.91
Variance		2.40	**-1.16**	0.79	0.21	1.44
Equity Index						
TIAA-CREF Returns	TIEIX	-2.18	2.24	3.96	2.00	6.05
RUSSELL 3000 INDEX	RAY	-2.20	2.24	4.02	2.06	6.12
Variance		0.02	0.00	**-0.05**	**-0.06**	**-0.07**
Lg Cap Value Index Fund						
TIAA-CREF Returns	TILVX	0.07	1.60	3.87	1.24	6.92
RUSSELL 1000 VALUE INDEX	RLV	0.09	1.68	3.89	1.31	7.11
Variance		**-0.02**	**-0.08**	**-0.02**	**-0.07**	**-0.19**
Sm Cap Index						
TIAA-CREF Returns	TISBX	-5.40	4.32	4.67	1.11	4.44
RUSSELL 2000 INDEX	RTY	-5.34	4.36	4.71	1.15	4.63
Variance		**-0.06**	**-0.04**	**-0.04**	**-0.04**	**-0.19**
International Equity						
TIAA-CREF Returns	TIIEX	0.55	-2.62	13.10	3.65	14.78
MSCI EAFE	MXEA	-0.17	-1.01	10.38	4.08	13.54
Variance		0.72	**-1.61**	2.72	**-0.43**	1.24
Bond Fund						
TIAA-CREF Returns		-0.47	3.09	-0.68	0.54	2.37
Lehman Agg Bond Index		-0.48	3.01	-0.67	0.59	2.44
Variance		0.01	0.08	**-0.01**	**-0.05**	**-0.07**

Sources: TIAA-CREF, Bloomberg

Findings: During 2005, several of TIAA-CREF's actively managed funds underperformed their respective benchmarks for two consecutive quarters or more and produced annual returns that trailed their benchmark by 100 bp or more. Obviously, any long-term underperformance of funds has the potential to offset the cost advantage that MO$T holds over most other State 529 programs. The three actively managed funds which showed the weakest performance in 2005 comprised 44% of the 100% Equity Option's allocation.

While it is beyond the purview of this report to provide an in-depth analysis of each fund's performance, I would note the following:

- Although the list of active funds that underperformed their benchmarks in 2005 is somewhat different than in 2004, we continue to see in general continued underperformance among TIAA-CREF's actively managed funds.
- Although the selection of Upromise as the new MO$T program administrator renders any further action on TIAA-CREF funds moot, in the future, the Board may also wish to consider instituting criteria for placing funds on "watch" or "probationary" status or

adopting other performance criteria. State Treasurer staff plan to jointly develop an Investment Policy with Vanguard for consideration by the Board later this year.

Participation Rate

In this section, we examine the participation rate of the MO$T program. By examining the participation rate for the program, one can attempt to gauge the relative success that the state's program has had in reaching the state's residents and encouraging them to increase college savings—the original goal of the IRS section authorizing these programs. The relative success or failure of states' various 529 programs rests on many different factors including the effectiveness of marketing efforts, demographic and economic conditions, customer service, their cost structure, the structuring of various investment options to appeal to different segments and provide diversification, and lastly but not unimportantly competition from other states.

The landscape for 529 programs has changed greatly since 1996, when only 12 states offered a college savings program. Not only do all 50 states now offer a qualified 529 program, but the number of different programs and the different models and strategies used by states has expanded greatly as well. From 1999 to 2005, assets in 529 savings plans grew from $1 billion to nearly $82 billion. During this time, the industry has seen a number of changes including:

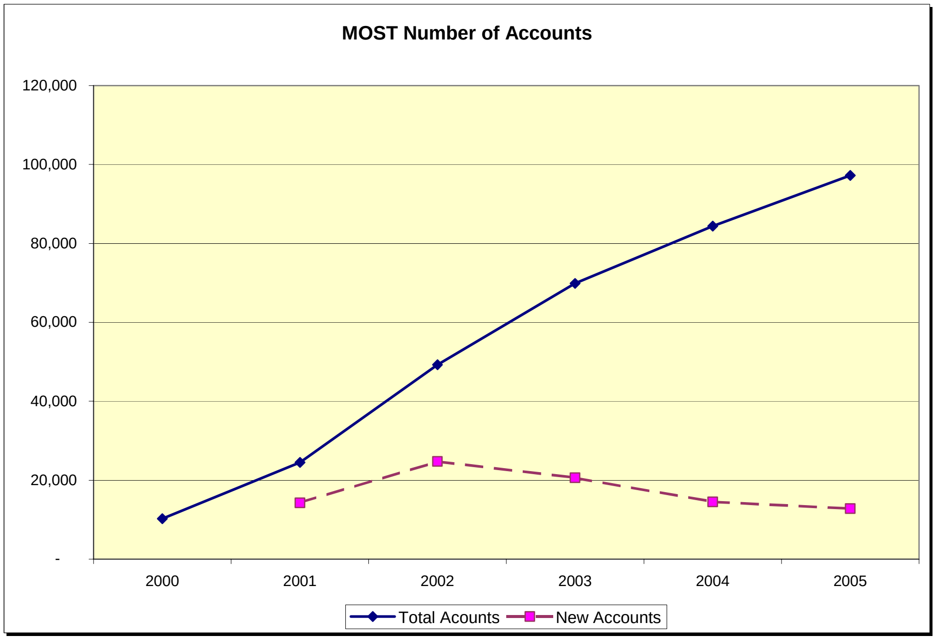
- A focus on in-state residents to now national portability
- The use by states of a single investment manager to multiple investment managers or funds
- The use by states of a single plan to multiple plans
- Increased use of brokers versus relying solely on program managers reaching investors directly
- Expansion in the products offered including guaranteed options, multiple age-based plans, menus of stand-alone mutual funds and CD's
- Consolidation in the industry and the exit of some firms
- Increased competition for assets across state lines

All of these factors present challenges to the marketing and success of states' plans. Additionally, measuring the participation rate for the MO$T program is not as straightforward as it would seem. Demographic and economic differences between states, the use of pre-paid plans by some states, differences in counting the number of accounts and the strategies used by certain states to attract out-of-state residents all make it difficult to compare states' plans. Nevertheless, we have attempted to evaluate participation in the MO$T program by reviewing the following information:

- What have been the trends for asset growth and participation for the MOST program over time?
- How do these trends and the state's overall participation compare nationally?
- How does the state's participation rate compare to similar states? Here, we selected a peer group of Midwestern states.

Participation in the MO$T Program

The growth rate of participation in the MO$T program has plateaued over the last two years, as seen in the following graph.



The following table shows the number of accounts by account type over the last five calendar years. The total number of accounts in the program increased 21% in 2004 and 15% in 2005. This compares to a growth rate in accounts of 42% in 2003 and 101% in 2002. The number of new accounts in 2004 and 2005 was in each year below 15,000, which is below that of both CY 2003 (20,606 new accounts) and CY 2002 (24,765). So, whether you measure the number of new accounts in absolute terms or by a percentage growth rate, 2005's results indicate a certain leveling off in the number of new accounts established.

Growth in Accounts by Account Type

Program Type	2001	2002	2003	2004	2005
Managed Allocation Option	16,045	28,408	37,571	44,540	50,854
100% Equity Option	5,482	11,217	14,934	18,152	21,378
Guaranteed Option	2,980	9,333	13,388	15,032	16,506
MOST 529 Advisor		314	3,985	6,670	8,454
Total	**24,507**	**49,272**	**69,878**	**84,394**	**97,192**
% Change	139%	101%	42%	21%	15%

Another way to analyze the growth rate of the program is to examine total contributions by year. Again, using this measure, we see a very steady figure from 2003 to 2005 with total contributions growing slightly from $183 million in 2003 to $194 million in 2005. This very

flat growth rate has not kept pace with the combined growth in the state's personal income and population during this time.

Contributions by Year				
Type	2002	2003	2004	2005
Initial Contributions	88,816,000	59,340,000	72,022,000	57,414,000
Contributions to Existing Accts	69,481,000	124,039,000	116,929,000	136,037,000
Adjustments				448,000
Total	158,297,000	183,379,000	188,951,000	193,899,000
% Change		15.8%	3.0%	2.6%

Nationally, we have also seen a slowing in the growth of 529 assets. Nevertheless, the fact that the MO$T program seemed to reach a plateau in 2005 is an indicator that new marketing strategies, product and/or lineup changes may be needed to reach market segments that show under-representation and to encourage greater savings among current users.

Comparison to National Statistics

Another method of analyzing participation in the MO$T program is to make a comparison of Missouri to our peers, namely other states. The table on the following page provides data for each state's 529 assets.

In this table, we have compared two separate measures of participation: (1) 529 assets per capita and (2) the penetration rate. The penetration rate is defined here as the ratio of total 529 Plan accounts to the total number of households in the state.2 Because of the many differences in states' programs, the purpose of this review was not to make individual comparisons of state's programs. Several states, such as Virginia and Maine, attract a much greater percentage of out-of-state monies because of the fee structure provided to the investment advisors marketing these programs. Investment advisors in non-resident states may advise placing their clients in these states' 529 programs due to the financial incentives provided. Other states, such as Michigan and Tennessee, have absorbed the inflation risk associated with tuition for state universities to residents, which offers a great incentive for in-state residents to participate but also creates the potential for a significant liability for the state.

[2] In this report, the number of accounts are measured differently based on different reporting methods used by TIAA-CREF. For reports provided to the Board, each separate investment option for a beneficiary is counted as a single account. Thus, if assets are invested for a child in the 100% Equity Option and the Managed Allocation option, that is counted as two accounts. For CSPN reporting, which is used to measure MO$T against other 529 programs, TIAA-CREF defines an account more narrowly; thus, in the above example, the child would be considered to have just one account.

Comparison of State 529 Assets and Penetration Rate

	529 Plan Statistics		Assets per Capita			Penetration Rate		
State	Assets	Accts	7/1/05 Population	Assets per Capita	Rank	Est. 2005 Housing Units	Accts/ Hsng Units	Rank
Alabama	1,125,949,200	123,877	4,557,808	$ 247.04	21	2,073,707	6.0%	18
Alaska	1,983,518,859	171,568	663,661	$ 2,988.75	3	273,971	62.6%	3
Arizona	317,423,625	41,792	5,939,292	$ 53.44	41	2,543,634	1.6%	41
Arkansas	130,121,397	11,159	2,779,154	$ 46.82	43	1,246,277	0.9%	47
California	1,741,018,225	174,930	36,132,147	$ 48.18	42	12,908,345	1.4%	44
Colorado	2,296,083,000	235,264	4,665,177	$ 492.17	11	2,038,490	11.5%	11
Connecticut	642,406,041	44,822	3,510,297	$ 183.01	26	1,419,013	3.2%	29
Delaware	278,990,625	22,304	843,524	$ 330.74	17	373,404	6.0%	19
District of Columbia	58,216,045	6,357	550,521	$ 105.75	32	274,744	2.3%	33
Florida	5,274,141,880	1,108,222	17,789,864	$ 296.47	19	8,195,749	13.5%	10
Georgia	329,427,632	52,248	9,072,576	$ 36.31	46	3,736,282	1.4%	43
Hawaii	31,047,133	3,018	1,275,194	$ 24.35	49	487,873	0.6%	48
Idaho	80,429,692	12,698	1,429,096	$ 56.28	40	592,861	2.1%	36
Illinois	2,347,272,264	176,069	12,763,371	$ 183.91	25	5,114,766	3.4%	27
Indiana	402,281,664	59,226	6,271,973	$ 64.14	39	2,710,253	2.2%	35
Iowa	1,297,421,752	118,395	2,966,334	$ 437.38	14	1,298,857	9.1%	14
Kansas	1,220,439,498	50,459	2,744,687	$ 444.66	13	1,189,878	4.2%	25
Kentucky	184,145,468	19,778	4,173,405	$ 44.12	45	1,857,019	1.1%	46
Louisiana	93,452,793	23,046	4,523,628	$ 20.66	50	1,927,077	1.2%	45
Maine	3,587,263,220	166,286	1,321,505	$ 2,714.53	4	680,022	24.5%	6
Maryland	1,313,570,104	104,205	5,600,388	$ 234.55	23	2,266,143	4.6%	24
Massachusetts	2,004,921,621	154,865	6,398,743	$ 313.33	18	2,668,458	5.8%	20
Michigan	2,119,255,026	212,431	10,120,860	$ 209.39	24	4,440,789	4.8%	23
Minnesota	394,617,958	38,932	5,132,799	$ 76.88	36	2,228,440	1.7%	39
Mississippi	208,758,152	27,051	2,921,088	$ 71.47	38	1,229,795	2.2%	34
Missouri	827,645,557	87,624	5,800,310	$ 142.69	30	2,582,496	3.4%	28
Montana	146,357,326	12,539	935,670	$ 156.42	28	427,258	2.9%	31
Nebraska	1,256,212,129	135,393	1,758,787	$ 714.25	8	762,548	17.8%	7
Nevada	2,171,955,623	265,959	2,414,807	$ 899.43	6	1,010,729	26.3%	5
New Hampshire	5,246,424,630	434,215	1,309,940	$ 4,005.09	2	580,444	74.8%	2
New Jersey	927,946,628	119,948	8,717,925	$ 106.44	31	3,427,619	3.5%	26
New Mexico	1,393,049,811	144,109	1,928,384	$ 722.39	7	836,549	17.2%	8
New York	4,603,862,000	413,731	19,254,630	$ 239.10	22	7,808,775	5.3%	21
North Carolina	218,821,347	22,659	8,683,242	$ 25.20	48	3,924,608	0.6%	50
North Dakota	290,116,788	23,452	636,677	$ 455.67	12	300,989	7.8%	17
Ohio	4,946,976,368	755,976	11,464,042	$ 431.52	15	4,972,775	15.2%	9
Oklahoma	163,146,757	27,196	3,547,884	$ 45.98	44	1,583,619	1.7%	40
Oregon	558,241,436	75,922	3,641,056	$ 153.32	29	1,556,626	4.9%	22
Pennsylvania	1,310,000,000	140,455	12,429,616	$ 105.39	33	5,401,000	2.6%	32
Rhode Island	6,370,015,607	417,139	1,076,189	$ 5,919.05	1	444,765	93.8%	1
South Carolina	691,097,053	59,263	4,255,083	$ 162.42	27	1,916,440	3.1%	30
South Dakota	507,945,488	38,019	775,933	$ 654.63	9	344,982	11.0%	12
Tennessee	85,647,878	12,143	5,962,959	$ 14.36	51	2,625,735	0.5%	51
Texas	1,751,487,924	170,537	22,859,968	$ 76.62	37	8,999,643	1.9%	38
Utah	1,291,610,313	79,270	2,469,585	$ 523.01	10	865,874	9.2%	13
Vermont	50,450,884	4,819	623,050	$ 80.97	35	305,181	1.6%	42
Virginia	15,247,558,115	1,246,076	7,567,465	$ 2,014.88	5	3,152,711	39.5%	4
Washington Prepaid	599,282,574	55,758	6,287,759	$ 95.31	34	2,640,518	2.1%	37
West Virginia	762,827,000	79,185	1,816,856	$ 419.86	16	869,005	9.1%	15
Wisconsin	1,587,623,082	207,502	5,536,201	$ 286.77	20	2,478,427	8.4%	16
Wyoming	16,652,110	1,354	509,294	$ 32.70	47	234,204	0.6%	49
TOTAL/AVERAGE	**82,485,127,302**	**8,189,245**	**296,410,404**	**$ 278.28**	**mean**	**123,829,367**	**6.6%**	**mean**
				$ 183.01	**median**		**3.5%**	**median**

NOTES:

1. Housing estimates were estimated based on the number of housing units in 2004 adjusted for the increase in population experienced in 2005.
2. Assets and number of accounts for State 529 plans were gathered from the College Savings Plan Network.

Nevertheless, a comparison of MO$T's penetration rate and assets per capita in Missouri to national averages can be useful. The MO$T program ranks near the middle of states at 28th in terms of its penetration rate. Compared to the national average penetration rate of 6.6%, Missouri falls below that with a penetration rate of 3.4%. This penetration rate is very close to the median of 3.5%, however.

In terms of 529 assets per capita, Missouri ranks 30th with $142 in 529 assets per capita. This compares to the national average of $278 and the median of $183. One of the possible reasons for why the penetration rate for MO$T is below the national average is "leakage" of a portion of the State's residents' monies to other state programs. Unfortunately, state 529 plans are not required to provide a breakdown of assets held by residents versus non-residents, so there is no way to quantify or evaluate the amount of "leakage" of Missouri residents' college savings assets to out-of-state plans. However, we know that some states' plans draw massively from out-of-state account owners based on the statistics in the table above.

In last year's report to the Board, we estimated that the potential leakage of out-of-state assets from Missouri may be as high as $700 million. We tend to doubt that the actual amount of Missouri residents' assets in other states' 529 plans is nearly this high, but such a methodology confirms that Missouri, like the majority of states, sees a large amount of leakage of residents' college savings to other states. This underscores the need to provide viable, attractive investment options and lower costs for Missouri residents. Consumers in the 529 market have choices and the 529 industry is likely to become even more competitive over time, rather than less.

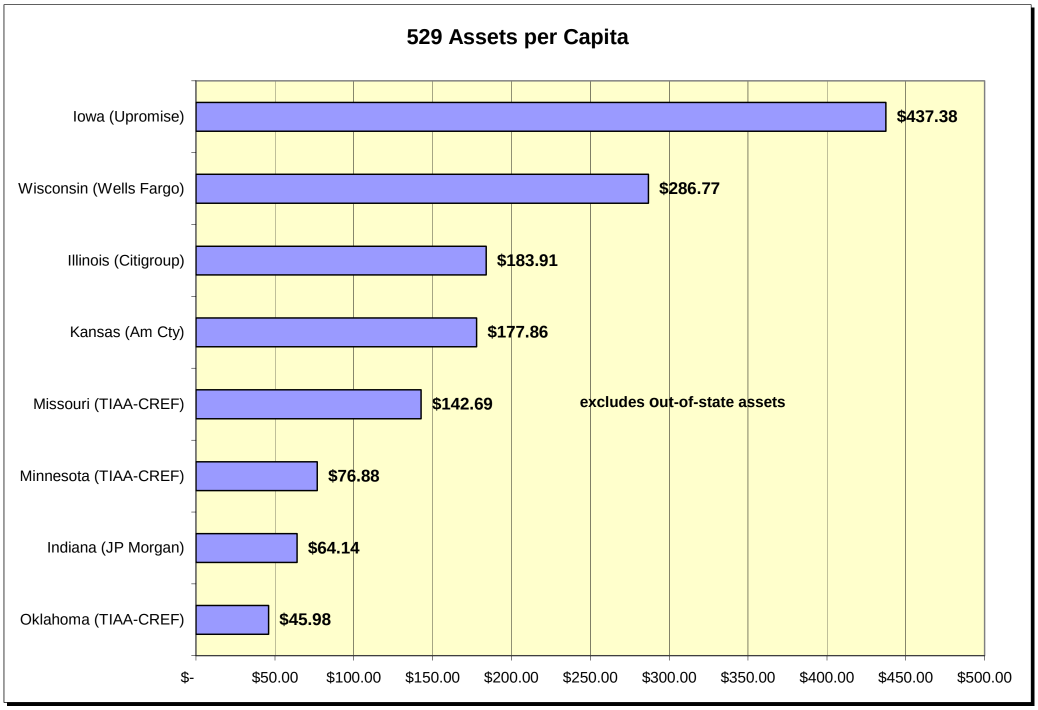
<u>Comparison to Peer Group</u>

In last year's report, we also compared the MO$T program to a peer group of Midwestern states. Missouri ranks well below Illinois, Iowa, Kansas and Wisconsin in terms of both the penetration rate and assets per capita.

	529 Plan Statistics		Assets per Capita			Penetration Rate		
State	Assets	Accts	7/1/05 Population	Assets per Capita	Rank	Est. 2005 Housing Units	Accts/ Hsng Units	Rank
Illinois	2,347,272,264	176,069	12,763,371	$ 183.91	3	5,114,766	3.4%	4
Indiana	402,281,664	59,226	6,271,973	$ 64.14	7	2,710,253	2.2%	6
Iowa	1,297,421,752	118,395	2,966,334	$ 437.38	1	1,298,857	9.1%	1
Kansas *	488,175,799	50,459	2,744,687	$ 177.86	4	1,189,878	4.2%	3
Minnesota	394,617,958	38,932	5,132,799	$ 76.88	6	2,228,440	1.7%	7
Missouri	827,645,557	87,624	5,800,310	$ 142.69	5	2,582,496	3.4%	5
Oklahoma	163,146,757	27,196	3,547,884	$ 45.98	8	1,583,619	1.7%	8
Wisconsin	1,587,623,082	207,502	5,536,201	$ 286.77	2	2,478,427	8.4%	2
TOTAL/AVERAGE	**7,508,184,833**	**765,403**	**44,763,559**	**$ 167.73**	**mean**	**19,186,736**	**4.0%**	**mean**
				$ 160.28	**median**		**3.4%**	**median**

* Kansas's assets were reduced by 60% based on an estimate of the number of out-of-state accounts in the Schwab and Learning Quest programs.

While the assets reported for several states such as Wisconsin likely include significant out-of-state assets, Missouri still ranks behind Illinois, where that is not the case, and Kansas, where we have backed out the roughly 60% of assets in the plan from outside the state. The following chart illustrates each state's 529 assets per capita.



Findings:

1. The MO$T program continues to rank near the median of all states in terms of the penetration rate to households.

2. Compared to neighboring or other Midwestern states, Missouri's penetration rate and assets per capita continue to lag that of states managed by Citigroup, Upromise and Wells Fargo.

3. In 2005, participation in the MO$T college savings programs continued to show that the program had plateaued. If one believes that we have reached a saturation point for households that were basically predisposed to participate in a 529 program, then there are essentially two ways in the future to increase participation: to attract or bring back out-of-state assets to Missouri or to reach segments in the market that remain underserved by current 529 programs.

Continued Viability

While the MO$T program certainly remains a viable, well-respected college savings program, in 2005 we saw the continuation of the trend first experienced in 2004 of flatter growth in new accounts for the program. Part of the reason for this phenomenon may well be the increased competition for 529 assets among states and their asset managers. I believe that these competitive pressures in the 529 industry are likely to increase, rather than decrease, in the future. With the growth in 529 assets and the implied increased profitability for 529 managers that this entails, we have seen a gradual but consistent reduction in program expenses among state programs. We have also seen three states—Maine, Kansas and Pennsylvania—enact laws to provide state tax deduction parity. As trustees of the program, one has to ask what changes are necessary to make the MO$T program more attractive and accessible to residents.

In late 2004, the Board took action in several areas to address these issues. The appointment of a new program manager and two investment manager partners provides greater opportunities for these firms to cross-sell the MO$T program. Just as importantly, the lineups of the investment options for the Direct and Advisor program have been greatly expanded.

While this report has focused on the Direct Plan, the Advisor Plan remains a critical element of the MO$T plan. There is evidence that broker-sold plans have overtaken directly sold programs in terms of accumulating 529 assets. The wider array of fund families now available to brokers in the MO$T Advisor Plan should greatly help in accelerating participation in this program.

With these changes, State Treasurer staff will be working with the new Upromise team to analyze the success of new marketing approaches, investment performance and the overall viability of the program. The regular reporting of these facets of the program to the Board is obviously critical to the Board's management of the program. The effective incorporation of the CD program into the State's 529 plan also presents an opportunity to enhance the MO$T program for the next four to five years. With the changes above adopted by the Board, the MO$T program is well positioned to grow, but an acceleration in the use of the program is also no certainty and will greatly depend on the skills and expertise of MO$T's new corporate partners during the next several years.

If you have any questions regarding the information in this report, please do not hesitate to contact me in the State Treasurer's Office at (573) 751-8530.